

# City and County of San Francisco

Office of the Controller – City Services Auditor

## **BOARD OF SUPERVISORS:**

### **Franchise Fee Audit of Astound Broadband, LLC**

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*November 23, 2009*

## **CONTROLLER'S OFFICE CITY SERVICES AUDITOR**

The City Services Auditor was created within the Controller's Office through an amendment to the City Charter that was approved by voters in November 2003. Under Appendix F to the City Charter, the City Services Auditor has broad authority for:

- Reporting on the level and effectiveness of San Francisco's public services and benchmarking the city to other public agencies and jurisdictions.
- Conducting financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operating a whistleblower hotline and website and investigating reports of waste, fraud, and abuse of city resources.
- Ensuring the financial integrity and improving the overall performance and efficiency of city government.

The audits unit conducts financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

We conduct our audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office (GAO). These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

Audit Team: Elisa Sullivan, Audit Manager  
Vivian Chu, Associate Auditor



**CITY AND COUNTY OF SAN FRANCISCO**  
**OFFICE OF THE CONTROLLER**

**Ben Rosenfield**  
**Controller**

**Monique Zmuda**  
**Deputy Controller**

November 23, 2009

Board of Supervisors  
City Hall, Room 244  
1 Dr. Carlton B. Goodlett Place  
San Francisco, CA 94102

President and Members:

The Controller's Office, City Services Auditor (CSA), presents its report concerning the audit of franchise fee payments Astound Broadband, LLC (Astound) made to the City and County of San Francisco (City) to operate an open video system within the City. The open video system franchise allowed Astound to provide cable service and internet service to its customers in the City. Each quarter, Astound was required to report its gross revenues from the operation of its cable service and to pay 5 percent of the gross revenues from its cable service as a franchise fee to the City. In addition, Astound was required to pay 3 percent of the gross revenues from its cable service for facilities and the support of public, educational, and governmental channels (PEG fees).

**Reporting Period:** March 13, 2007, through October 28, 2008

<b>Fees Paid:</b>	Franchise Fees:	\$180,283
	PEG Fees:	<u>103,977</u>
	Total:	\$284,260

**Results:**

Astound correctly paid the franchise and PEG fees due to the City, but did not make 8 of the 16 payments due during the audit period in a timely manner. As a result, Astound owes \$919 in interest charges.

Responses from the Department of Technology (DT) and Astound are attached to this report. CSA will work with DT to follow up on the status of the recommendations made in this report.

Respectfully submitted,

Tonia Lediju  
Director of Audits

cc: Mayor  
Board of Supervisors  
Civil Grand Jury  
Public Library  
Budget Analyst

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# INTRODUCTION

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## Audit Authority

The Office of the Controller (Controller) is required under San Francisco Administrative Code, Chapter 11, Article V, Section 11.44(a) to file a report no less than every two years with the Board of Supervisors analyzing whether a franchisee is complying with the audit, reporting requirements, and payment obligations contained in Chapter 11 and the franchise ordinance. In addition, the City and County of San Francisco (City) has the right under San Francisco Administrative Code, Chapter 11, Article V, Section 11.38 to access the books and records of a franchisee to monitor compliance with Chapter 11 of the Administrative Code, the franchise ordinance, or other applicable law. Further, the City Charter provides the Controller, City Services Auditor (CSA), with broad authority to conduct audits. We conducted this audit under these authorities.

## Background

On July 25, 2000, the City's Board of Supervisors (Board) awarded a cable system franchise to RCN Telecom Services, Inc. (RCN). Effective October 28, 2004, the Board allowed RCN to terminate its cable franchise and replace it with an open video system franchise for a four-year period. An open video system franchise allows the provider to supply cable service and internet service to its customers in the City. RCN subsequently transferred the franchise to Astound Broadband, LLC (Astound) and the Board approved the transfer on January 23, 2007. The purchase of RCN by Astound was completed on March 13, 2007, and the franchise agreement subsequently expired on October 28, 2008. Astound now has a franchise with the State of California under California Public Utilities Code, Section 5860, which regulates cable operators. However, Astound is still required to pay fees to the City.

The City's Department of Technology (DT) was responsible for overseeing the franchise. The City's Administrative Code, Section 11.22 required Astound to report each quarter its gross revenues from the operation of its cable service, and to pay 5 percent of the gross revenues from its cable service as a franchise fee to the City. Astound was also required to pay 3 percent of its gross revenues from its cable service for facilities and operation of public, educational, and governmental channels (PEG fees).

Astound was required to pay its franchise fees and other fees within 40 business days after the end of each quarter.

## **Scope and Methodology**

The purpose of this audit was to determine whether Astound correctly reported its gross revenues from its cable service and correctly paid the City the franchise fees and other fees due from March 13, 2007, through October 28, 2008. To determine whether Astound correctly reported gross revenues for the audit period, the audit team tested on a sample basis Astound's supporting records for those revenues and assessed the timeliness of Astound's franchise fee payments. As part of this audit, the audit team interviewed staff from Astound, DT, and the Office of the City Attorney.

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require planning and performing the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. We believe that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

# AUDIT RESULTS

## Astound Correctly Paid Franchise Fees and PEG Fees to the City

Astound Broadband, LLC (Astound) correctly paid \$180,283 in franchise fees and \$103,977 in PEG fees to the City for the period from March 13, 2007, through October 28, 2008. Exhibit 1 summarizes Astound's reported gross revenues and franchise fees paid.

### EXHIBIT 1 Revenue Reported and Fees Paid March 13, 2007, through October 28, 2008

Reporting Period	Subscribers	Revenues Reported	Franchise Fee Rate	Franchise Fees Paid	PEG Fee Rate	PEG Fees Paid
Mar 13 - Mar 31, 2007	2,931	\$ 111,901	5%	\$ 5,595	3%	\$ 3,357
Apr 1 - Jun 30, 2007	8,765	627,304	5%	31,365	3%	18,819
Jul 1 - Sept 30, 2007	8,486	591,964	5%	29,598	3%	17,759
Oct 1 - Dec 31, 2007	8,373	500,549	5%	25,027	3%	15,016
Jan 1 - Mar 31, 2008	8,378	495,957	5%	24,798	3%	14,879
Apr 1 - Jun 30, 2008	8,637	514,395	5%	25,720	3%	15,429
Jul 1 - Sept 30, 2008	8,922	570,490	5%	28,525	3%	17,115
Oct 1 - Oct 28, 2008	3,082	193,098	5%	9,655	0.52/per Subscriber*	1,603
<b>Totals</b>	<b>57,574</b>	<b>\$3,605,658</b>		<b>\$ 180,283</b>		<b>\$ 103,977</b>

Note: Starting October 2008, the PEG fee was changed to \$0.52 per subscriber.

Source: Astound Broadband, LLC.

## Astound Owes Interest on Late Franchise Fee and PEG Fee Payments

Astound did not make 8 of the 16 payments for franchise and PEG fees due during the audit period in a timely manner. The payments for March 2007, Astound's first month of operations, were not received until more than 60 business days after the end of the quarter. Astound was required to pay its franchise fees and other fees within 40 business days after the end of each calendar quarter. The San Francisco Administrative Code, Section 11.27 states that an interest rate of 1.5 percent per month is to be charged on payments not received by the City on or before the due date. DT, the department that administered the franchise agreement, did not initiate the charging of late fees. As a result, Astound owes the City \$919 in interest on late payments.

**EXHIBIT 2****Interest Due on Late Payments  
March 13, 2007, through October 28, 2008**

Transaction Description	Amount	Post Date	Due Date	Date Received	No. of Days Late	Interest Due
Mar 2007 Franchise Fees	\$ 5,595	8/28/07	5/25/07	8/24/07	63	\$ 176
Mar 2007 PEG Fees	3,357	10/12/07	5/25/07	9/26/07	84	141
Apr - Jun 2007 Franchise Fees	31,365	10/12/07	8/27/07	9/12/07	12	188
Apr - Jun 2007 PEG Fees	18,819	10/12/07	8/27/07	9/12/07	12	113
Jan - Mar 2008 Franchise Fees	24,798	6/10/08	5/26/08	6/3/08	6	74
Jan - Mar 2008 PEG Fees	14,879	6/10/08	5/26/08	6/3/08	6	45
Jul - Sept 2008 Franchise Fees	28,525	12/12/08	12/1/08	12/9/08	8	114
Jul - Sept 2008 PEG Fees	17,115	12/12/08	12/1/08	12/9/08	8	68
<b>Totals</b>	<b>\$144,453</b>					<b>\$ 919</b>

Source: Auditor's calculations.

**Recommendations**

DT should:

1. Remind Astound to make its payments for franchise fee and PEG fees on a timely basis.
2. Require Astound to pay \$919 in interest on late payments to the City.
3. Coordinate with the Controller to charge and collect interest on all late franchise fee payments.



## ATTACHMENT A: DT'S RESPONSE

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City & County of San Francisco

**Department of  
Technology**

*Power to the People*

One South Van Ness Avenue, 2nd Floor  
San Francisco, CA 94103-0948  
Office: 415-581-4001 • Fax: 415-581-4002

**DATE:** November 19, 2009

**TO:** Tonia Lediju, Director of Audits, CSA  
Office of the Controller

**FROM:** Ron Vinson, Director of Media

**SUBJECT:** Audit of Astound Broadband

### Department of Technology Response

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The Department of Technology (DT) has reviewed the Controller's audit of Astound Broadband (Astound), and agrees with the Controller's conclusion that Astound has properly paid all franchise fees and PEG fees owed to the City. DT also agrees with the conclusion that certain fee payments were received late according to the terms of the Open Video Services agreement between Astound and the City.

DT notes that fee checks are sent directly to the Controller and, in the past, DT only received notice that the fees had been paid when they were posted to the appropriate account. The time periods between fee receipt date and posting date will vary significantly, which made it difficult for DT to determine when Astound's fees were actually received by the Controller. DT and the Controller have recently initiated a process whereby the Controller will notify DT of the receipt date of each franchise fee and PEG fee payment. This process should ensure that DT, in the future, timely identifies and initiates late fee collections actions with the Controller.

DT also notes that, with one exception, the fees were not seriously delinquent. The one case in which fees were significantly late occurred for two partial quarterly payments for March 2007. This was the first month in which Astound assumed control of the cable system from the prior owner, which was in bankruptcy. Astound claims that they were unable to timely obtain necessary information from the prior owner to calculate the proper amount due. Astound requests forgiveness of these late fees for that reason. However, given the circumstances of this transfer and the long period of time before the fees were actually paid, DT sees no justification to forgive these fees. We note that Astound had ample opportunity to request an extension or waiver of the penalties at the



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time that the fees were initially due, but failed to do so. Therefore, DT declines to forgive the late fees for the March 2007 payments and require Astound to pay all late fees identified by the Controller.

Finally, DT notes that recent changes to California state law have changed the timing for payment of franchise fees and PEG fees, and also the interest rate to be applied when calculating late fees. Specifically, California Public Utilities Code Sections 5860(h) and 5870(m) provide that franchise fees and PEG fees shall be remitted quarterly, within 45 days after the end of the quarter, for the preceding calendar quarter. In addition, Section 5860(h) provides that if the franchise fee is not paid when due, the City may assess a late payment charge "at a rate per year equal to the highest prime lending rate during the period of delinquency, plus 1 percent." DT will send a written reminder of these changes to all state franchised video service providers operating in the City.

In summary, DT will take the following actions:

- DT will send Astound a written reminder of the new laws regarding late payments, and the consequences of failure to pay the fees on a timely basis.
- DT declines to grant Astound's request for forgiveness of the March 2007 penalty, and will require Astound to pay all late fees identified by the Controller.
- DT has worked with the Controller to initiate a process whereby DT staff begins receiving timely notice when any franchise fees or PEG fees are received. DT will notify the Controller when such fees are received late and request that the Controller collect any late fees due from Astound.

Recommendation	Responsible Agency	Response
1. Remind Astound to make its payments for franchise fee and PEG fees on a timely basis.	DT	DT will send Astound a written reminder of the new laws and the consequences of failure to pay the fees on a timely basis.
2. Require Astound to pay \$919 in interest on late payments to the City.	DT	DT declines to grant Astound's request for forgiveness of the March 2007 penalty, and will require Astound to pay all late fees identified by the Controller.
3. Coordinate with the Controller to charge and collect interest on all late franchise fee payments.	DT	DT has worked with the Controller to initiate a process whereby DT staff begins receiving timely notice when any franchise fees or PEG fees are received. DT will notify the Controller when such fees are received late and request that the Controller collect any late fees due from Astound.

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# ATTACHMENT B: ASTOUND'S RESPONSE

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November 5, 2009

Tonia Ledju, Director of Audits  
City Hall, Room 477  
1 Dr. Carlton B. Goodlett Place  
San Francisco, CA. 94102

Dear Ms. Ledju:

Astound Broadband, LLC ("Astound") has reviewed the City and County of San Francisco's Draft Report for the payment of franchise and PEG fees from March 2007 to October 2008. It is agreed that Astound correctly paid the franchise and PEG fees, along with a few untimely payments.

Astound is willing to admit fault to the late payments and agrees to pay the \$919.00 in interest charges, although would like to ask for forgiveness on March 2007's late payment. Due to acquiring this franchise on March 13, 2007, Astound was not able to gather the necessary information to calculate and pay the franchise and PEG fees within a timely manner. Astound would like the City's Department of Telecommunications and Information Services to consider waiving the \$317.00 late fee for March 2007.

In all, Astound is satisfied with the audit results made by the City and County of San Francisco. Should you have any further questions, please feel free to contact our office.

Sincerely,

  
Lisa Cundiff

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